Chairman Quello went on to note that cable regulation and the overturn of the Commission's forbearance policies, which resulted in the requirement that all common carriers file tariffs, have also added substantially to the Commission's workload.

Chairman Reed E. Hundt echoed these concerns before the House Telecommunications and Finance Subcommittee:

> The strain of inadequate resources at the Commission is evident in several respects. The infrastructure of the agency, from where it houses its employees to the quality of its equipment, is in need of substantial upgrading. More critically, the agency is woefully short of human resources. Staff must be marshaled from around the entire agency to ensure expeditious resolution of any significant matter.[72]

The Chairman testified that for these reasons, "the inadequacy of the Commission's current resources has reached crisis proportion."[73] Chairman Hundt also pointed out that between 1980 and 1993, the number of full-time equivalent positions at the Agency had fallen from 2,200 to 1,724.[74] The additional staff that the Agency's 1994 appropriation permitted it to hire will not restore staffing to the 1980 level. Moreover, the increase in staff was designed specifically to implement the Cable Act, and will do nothing to relieve the critical shortages in other areas of regulation.

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[72] See, "Testimony Concerning the 1995 Authorization Act for the Federal Communications Commission," May 26, 1994, p. 2.

[73] *Id.*, p. 1.

[74] *Id.*, p. 5.

The Commission's inability to do any serious enforcement is well documented by various General Accounting Office audits over the years.[75] The limited audits that the Commission or NARUC have conducted inevitably unearthed problems. The probability of detection is so small, and the consequences so small, that there is little incentive for the RBOCs to police themselves.

VI. GROWING COMPETITION IN THE ENHANCED SERVICE MARKET DOES NOT PROVE THAT UNBUNDLING IS UNNECESSARY

The Commission asks whether development of competition in the enhanced service market obviates the need to require structural safeguards. The answer is clearly no. First, enhanced service providers are still depend on access to local telephone company networks. The degree of competition in the dependent market does not change this fact. With this dependence comes the incentive and opportunity for local telephone companies to behave anticompetitively. Second, an examination of how competition is evolving in the enhanced service business shows that the services being offered are incredibly diverse. This provides the local telephone companies with the opportunity to use discrimination to reduce competition in particular enhanced service markets. Finally, implicit in the Commission's argument is the notion that competition has developed as a result of application of its non-structural safeguards. In fact, competition in enhanced service markets has grown in spite of, and not because of, Commission policies.

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[75] See U.S. General Accounting Office, FCC's Efforts to Control Cross-Subsidization, February 1993, for a recent example.

A. Enhanced Service Provider Reliance on Access to Local Telephone Networks Provides the Incentive and Opportunity for Discrimination.

As discussed in Section I, the simple fact is that, in their respective regions, the local telephone companies still control the only local, two-way, switched communications network available to the vast majority of Americans. While these local exchange networks were originally designed for ordinary voice communications, they also remain the only widely available, local, two-way switched communications networks on which most enhanced services rely. Moreover, in most instances, the RBOCs also still control the only local, dedicated, two-way wideband and broadband, facilities available for the origination and termination of large volumes of voice and data traffic in their respective geographic areas.

The growth to date in the number of ESPs does nothing to change the fact of the local monopoly. The incentives that local telephone companies have to use their control over the local exchange are not reduced as the number of enhanced service providers increase. Local telephone company profits can still be increased by discrimination and cross-subsidy. Indeed, as the market has grown, the opportunities for discrimination have grown with it. Finally, with the growth and increasing diversity of the enhanced service markets, the job of policing local telephone company behavior is all the more difficult.

Due to the failure of the Commission's ONA policies, enhanced service competition has, by default, evolved using fairly simple interfaces to the local telephone network. Evolving technology together with further unbundling will affect the way in which enhanced service providers may want to interconnect with local telephone networks (See Section III). Therefore,

today's state of competition may not be a particularly reliable guide to how enhanced service competition will evolve in the future.

B. Enhanced Service Markets Are Diverse

There is not a single enhanced service market. Instead the enhanced service business consists of a wide variety of individuals services ranging from voice mail to general interest videotext services to special purpose business oriented on-line information services. Many of these individual services may occupy individual antitrust markets that could easily be monopolized through local telephone company discrimination, even if there are multiple competitors today. Therefore, an anti-competitive strategy makes sense because the RBOCs can eliminate competition one market at a time.

C. Enhanced Service Competition Is Not Due to Commission Policies

Competition in enhanced services markets is evolving despite, and not because of, Commission policies. Most of the services discussed in the previous section are accessed over ordinary dial-up telephone lines. These lines were available prior to Computer III. The success of these services has not depended on the use of unbundled features and functions within the local telephone network. This is not to say that these services could not benefit from reasonably priced access to such features.

It would not be appropriate to argue, as the Commission implicitly does, that the growth of enhanced services is due to Commission policies. The failure of ONA has likely prevented some features and functions from being added to these services, which would promote their growth. For example, electronic mail services could benefit from availability of a "message waiting" indicator on lines used for accessing these services. Similarly, these services would

benefit greatly from widespread access to ISDN lines, which would allow much faster download of information and more rapid printing of information to computer screens. The local telephone companies have restricted the functionality of ISDN.

One enhanced service where competitors have had to rely on access to network features and functions is voice messaging services (VMS). Not surprisingly, there have been competitive problems in the VMS market, manifested most notably in the Georgia MemoryCall case.[76] In that case, BellSouth had entered the voice message service (VMS) market with a product known as "MemoryCall." However, competing VMS providers had long alleged that BellSouth was blatantly and systematically discriminating against them by choosing not to provide service competing VMS providers requested, by offering services BellSouth's VMS product could use without regard to the needs of independent VMS provider needs, and by establishing predatory prices for MemoryCall services.

In its investigation into allegations of BellSouth abuse, the Georgia Public Service Commission determined that BellSouth had (1) both the ability and the incentive to abuse its monopoly control over the local telephone network, and (2) in fact had abused that monopoly control in order to gain an unfair advantage over competing VMS providers:

> The Commission has determined that SBT [Southern Bell Telephone] has the opportunity and incentive to behave anticompetitively in that [VMS] market in order to favor its MemoryCall service over other competitive VMS options. The Commission has further determined that SBT has in fact behaved anticompetitively with respect to its trial offer of MemoryCall service, with inevitable and likely irreparable damage to the VMS marketplace. The full scope and extent of this damage and of SBT's anticompetitive behavior cannot presently be determined by the Commission, given SBT's failure to comply with the

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[76] Memory Call Order, *op. cit.*

Commission's earlier directive that SBT file with the Commission sufficient cost data to allow a determination as to whether MemoryCall service is being predatorily priced.[77]

This was a problem that occurred despite explicit Commission Rules to deter such behavior. This conduct took place notwithstanding a CEI plan for MemoryCall services that had been approved by the Commission.[78]

VII. A COST/BENEFIT ANALYSIS DEMONSTRATES THAT THE COMMISSION SHOULD NOT GRANT STRUCTURAL RELIEF TO LOCAL TELEPHONE COMPANIES

The costs of eliminating structural separation would likely far exceed the benefits. The potential costs include:[79]

- Risk of anticompetitive behavior
- Cost of the antitrust suits that would follow
- Costs of litigation and enforcement when access arrangements are not identical
- Additional cost of enforcing accounting rules in the face of larger common costs
- Negative incentive effects of failing to enforce the original ONA requirements
- The need for more enforcement resources on the Commission's part
- Additional regulatory burdens on RBOCs due to the need to make compliance filings

The theoretical benefits include the following:

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[77] *Id,.* at pp. 3-4.

[78] BellSouth Plan for Comparable Efficient Interconnection for Voice Messaging Services, 3 FCC Rcd 7284 (1988).

[79] Costs and benefits were discussed in Kenneth C. Baseman and Stephen D. Silberman, The Economics of Line of Business Restrictions and Structural Separations, January 20, 1986, filed with MCI Computer III Comments.

- Realization of economies of scale and scope
- RBOCs might offer new services

It is clear that there are costs of abandoning structural separation. Structural separation will serve to reduce discrimination and cross-subsidy. Anticompetitive behavior by the RBOCs can damage the evolution of critical enhanced service markets, and thereby impose substantial costs on consumers. This consideration must play a key role in any cost/benefit analysis.

Further unbundling is even less likely to occur unless and until such time as the RBOCs come to realize it is in their own interests to increase network utilization by stimulating use of unbundled network elements. As noted in Section I, further unbundling would produce enormous benefits, not only in the enhanced service market, but also in long distance and local exchange markets. Eliminating structural separation rules now eliminates any inducement to further unbundling.

In a similar vein, the cost of establishing structurally separated subsidiaries for services that are already being offered on an integrated basis is not, from a public policy perspective, a legitimate cost to be considered. To give the telephone companies "credit" for these expenses in a cost-benefit analysis would reward them for the bait and switch tactics that were used to gain structural relief in the first place. Any short term efficiency gains created by allowing the telephone companies to continue integrated operation could be outweighed by the incentive created to attempt to manipulate the system again in the future.

The costs of eliminating structural separation requirements are likely to far exceed any benefits. These costs,which include anticompetitive behavior and all of the negative consequences of that behavior, may reduce dynamic efficiency in the economy as a whole due to

the key role that ESPs are playing in developing the information economy. The benefits, if any, have never been demonstrated.

RBOCs are already allowed to compete in enhanced services markets. As discussed above, it is generally conceded that most of these markets are competitive, with an increasing array of services being made available to consumers from a variety of providers. The explosive growth of the Internet, discussed in Section III, has multiplied the services available to consumers and businesses on line at a virtually exponential rate. Given this robust competition, elimination of structural separation rules could increase diversity in the enhanced service markets only if the RBOCs would thereby be induced to offer enhanced services that they would not offer otherwise and that no other provider would be willing to offer. This is likely only if there are services that RBOCs are uniquely positioned to offer. In turn, this is likely to be the case only if there are economies of integration they are uniquely in a position to exploit.

The RBOCs have never demonstrated benefits to technically integrating information services within the local telephone network. Indeed, the original concept of ONA, which the local telephone industry endorsed, is itself inconsistent with the notion that there are such economies. If a network is truly open, any customer can take advantage of all of its features and functions.

If, on the other hand, the RBOCs can demonstrate that there are services that could not be made available by <u>any</u> providers absent structural integration for RBOC enhanced services, the

Commission can grant them flexibility through waivers on a case by case basis.[80] Broad elimination of structural safeguards that provide protection to competitors is not necessary.

[80] They would, of course, need to demonstrate that the lack of providers is not caused by an RBOC failure to provide appropriate interfaces to their network elements.

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Statement of Qualifications

General Qualifications

Hatfield Associates, Inc. (HAI) is an interdisciplinary consulting and research firm serving a wide range of clients with stakes in the telecommunications field. The firm has provided consulting and educational services in nearly all aspects of the present and future telecommunications infrastructure, including local exchange networks, cable television systems, competitive access services, land mobile and personal communications, long haul terrestrial and satellite communications, data communications, and customer premises equipment.

Principals of the firm include consultants with graduate degrees and decades of senior level experience in engineering, economics, business, and policy/regulation. HAI's services include, among others, regulatory filings and policy studies, engineering studies, expert testimony, market research, economic studies, "due diligence" support, business planning, education and system development.

Examples of recent consulting assignments include:

- Analyzing the potential for competitive entry into the local exchange telecommunications business, presented in a paper entitled "The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers";

- Developing material on telecommunications technology for inclusion in a report on international telecommunications prepared by the Office of Technology Assessment of the U.S. Congress;

- Preparing a report entitled "Cross-Subsidy Concerns Raised by Local Exchange Company Provision of Video Dialtone Services" that was attached to a petition filed with the Federal Communications Commission (FCC) by the National Cable Television Association and the Consumer Federation of America;

- Managing the regional hub field testing program for Cable Television Laboratories;

- Assisting a client in the preparation of comments in an FCC proceeding dealing with the future of the private land mobile radio services;

- Assessing opportunities for the branches of the U.S. Military to consolidate their use of wireless communications;

- Testifying in several state proceedings on various aspects of competitive entry into local exchange and exchange access services;

- Providing analyses for an investment firm contemplating a major investment in a paging company;

- Developing a vision statement dealing with the future of cable television networks in providing telecommunications and enhanced video services;

- Determining the viability of an energy utility's entry into the telecommunications field;

- Providing telecommunications education to countries in Central and Eastern Europe;

- Wrote the "Telecommunications Technology" and "Utility Applications of Telecommunications" chapters, describing utility opportunities in telecommunications, of a major telecommunications report for the Electric Power Research Institute;

- Analyzed telecommunications opportunities and mode of entry for a major southwest electric utility, leading to a decision by that utility to deploy a backbone fiber optics network;

- Analyzed the cost of deploying a telecommunications network for a southeast electric utility; and

- Analyzed the telecommunications resources and service opportunities for another electric utility.

Qualifications in Telecommunications Education

HAI and its principals have been heavily involved in telecommunications education, and such education represents a significant portion of the firm's consulting business. Course topics range from the basic terms and concepts of telecommunications to enterprise computer networking, and also include, for instance, the telecommunications infrastructure, issues concerning the structure and management of the North American Numbering Plan, and the architecture and technology of wireless communications.